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In the Supreme Court of the United States

OCTOBER TERM, 1957

LEWIS THURSTON ANDERSON AND CLYDE VELMA ANDERSON, PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

J. LEE RANKIN,
Solicitor General,

CHARLES K. RICE,
Assistant Attorney General.

HARRY BAUM,
MELVIN L. LEBOW,
Attorneys,
Department of Justice,
Washington 25, D. C.

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 901-960) are not officially reported. The opinion of the Court of Appeals (Pet. 28-45) is reported at 250 F. 2d 242.

JURISDICTION

The judgment of the Court of Appeals was entered on December 6, 1957. A petition for rehearing was denied on December 30, 1957. The petition for a writ of certiorari was filed on March 27, 1958. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the record warrants the Tax Court's finding, affirmed by the court below, that certain secured notes owned by the taxpayer had an average fair market value of 70 percent of their face amounts.

2. Whether the record warrants the Tax Court's finding, also affirmed by the court below, that certain property sold by the taxpayer was held primarily for sale to customers in the ordinary course of business, and that consequently the sales profits were taxable as ordinary income rather than as capital gain.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

* * * * *

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

(26 U.S.C. 1952 ed., Sec. 111.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) [as amended by Sec. 115(b), Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), * * *, or real property used in the trade or business of the taxpayer;

* * * * *

(j) [as added by Sec. 151(b), Revenue Act of 1942, *supra*] *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(26 U.S.C. 1952 ed., Sec. 117.)

STATEMENT

The pertinent facts, as found by the Tax Court (R. 903-929), may be summarized as follows:

The taxpayer, Lewis Thurston Anderson, commenced acquiring real estate in and around Augusta, Georgia, in 1917. His earliest acquisitions were for the purpose of producing rental income. The acquisition of real estate by the taxpayer was a continuous process, at least from 1926 on, and prior to 1946 taxpayer acquired a tract of at least 50 acres on the Sand Bar Ferry Road outside of the City of Augusta. He subdivided the Sand Bar Ferry tract into 60 building lots and constructed houses on it, some of which were initially built for rental and some for sale.

These latter houses, and three more that he had on hand at December 31, 1948, were the only houses that

the taxpayer constructed primarily for sale. They were built by the taxpayer in order to enable him to dispose of the land which was the back part of the tract. (R. 907.)

In the years 1942 to 1948, inclusive, the taxpayer, in addition to sales of other property, sold parcels of real estate and unimproved land as listed below. (R. 907-908.) The aggregate numbers of parcels, selling prices, costs, amounts of depreciation and gains were as follows (R. 908):

Year	No. Parcels	Selling Price	Cost	Depreciation	Gain
1942.....	5	$10,300.00	$ 7,599.17	$ 977.00	$ 3,677.83
1943.....	2	5,600.00	4,300.97	30.00	1,329.03
1944.....	1	1,850.00	1,625.00	235.12	460.12
1945.....	21	48,950.00	29,512.80	7,745.25	27,183.45
1946.....	12	29,696.80	21,244.70	2,351.25	11,803.35
1947.....	13	51,650.00	23,661.59	3,931.25	31,919.66
1948.....	5	18,316.66	6,257.78	660.00	12,718.88

Each of these parcels had been held by the taxpayer for more than six months. Some of the parcels were improved and some were unimproved. Each of the parcels that had a house on it had been rented before it was sold. In almost every case, the purchaser or a relative of the purchaser approached the taxpayer with an offer to purchase the property. The taxpayer sometimes paid a commission on such sales to persons who were not real estate agents. He sold to anyone who wanted to buy. He sometimes sold without receiving a down payment. (R. 908.)

On his sales of real estate the taxpayer received from the purchasers security deeds to secure notes for the unpaid portion of the purchase price. The notes bore interest at varying rates from 5 percent to 8 percent. (R. 911-912.) In some instances the property was sold with no down payment or with a small down payment.

In other instances substantial down payments were made. (R. 940.) At the close of each of the years listed below the taxpayer owned security deeds acquired in connection with real estate sales in the several counties listed in the numbers and face amounts as follows (R. 912):

Year	No.	Aiken County	No.	Richmond County	No.	Jefferson County	Totals
1940.....	0	.....	1	$ 1,926.00	1	$425.00	$ 2,351.00
1941.....	0	.....	1	1,710.00	1	425.00	2,135.00
1942.....	2	$ 3,438.62	1	1,000.00	1	425.00	4,863.62
1943.....	2	3,307.54	2	3,132.97	0	.....	6,440.51
1944.....	2	3,130.70	2	3,456.45	0	.....	6,587.15
1945.....	15	29,330 67	8	14,464.97	0	.....	43,795.64
1946.....	17	32,056.18	13	26,744.30	1	107.00	58,907.48
1947.....	16	27,854.72	31	99,600.56	1	107.00	127,562.28
1948.....	15	25,325.87	39	140,574.05	0	.....	165,899.92

During the years in question many of the security deeds covering properties sold by the taxpayer were satisfied (R. 910.)

Some of the security deeds were on property in the Sand Bar Ferry tract. That tract was outside of the city limits and the houses built thereon were not subject to the city building code. They were, in many respects, sub-standard in construction and materials and had no baths or other sanitary facilities. The streets in the area were unpaved, and there were no street lights. (R. 912.)

No real estate firm in Augusta has ever sold any of the taxpayer's houses in the Sand Bar Ferry Road area. The houses could not qualify for F.H.A. loans and savings and loan associations would not make improvement loans on the properties (R. 913.)

Houses owned by the taxpayer in Augusta, Georgia, some of which he sold in the taxable years, and on which he took back notes secured by security deeds, for the most part were also of sub-standard construction. Some

of them had been built 50 or 60 years ago to rent at $15 to $20 per month. Some were rented at monthly rentals of from $4 to $7. The taxpayer's properties, generally, were properties that were hard to finance. (R. 913.)

The average of the value of the real estate underlying the security deeds which secured the notes, as stated by the witnesses, was over 56 percent of the face amount of the notes (R. 940), and the taxpayer's evidence shows that within the years in which sales were made he received substantial collections on the notes (R. 941).

The court below affirmed (Pet. 36-39) the findings of fact made by the Tax Court that: (1) The secured notes held by the taxpayer on properties that were sold by him had a fair market value of 70 percent of their face amounts (R. 913); and (2) the real estate sold by the taxpayer was property held by him primarily for sale to customers in the ordinary course of his business (R. 908-909). Judge Hutcheson, dissenting, was of the view that the determinations of the Tax Court as to value of the notes and as to the purposes for which the taxpayer held his real estate before sale were clearly erroneous. (Pet. 42-45.)

ARGUMENT

This case presents only factual issues. The Tax Court's determination was properly affirmed by the Court of Appeals, and the concurrent findings of both courts below are entitled to finality here. There is no conflict, nor any other reason for further review.

1. It is well settled that valuation of property presents an issue of pure fact, and that the trial court's

determination should not be disturbed if it has a basis in the record. *Elmhurst Cemetery Co.* v. *Commissioner*, 300 U.S. 37; *Olson* v. *United States*, 292 U.S. 246; *Plaut* v. *Munford*, 188 F. 2d 543 (C.A. 2d). In the Tax Court the Commissioner contended that certain purchase money notes owned by the taxpayer and secured by real estate he sold were worth 100 per cent of their face amount, while the taxpayer contended that they were worth only 30 percent. (R. 939.)[1] The Tax Court, on the basis of all the evidence, found that the secured notes were worth on the average 70 percent of their face amount (R. 941), and the court below agreed (Pet. 36-39).

In valuing secured obligations the two principal guides are (1) the value of the security underlying the obligation, and (2) whether the secured obligations were income producing. See, *e.g.*, *Rogers* v. *Helvering*, 107 F. 2d 394, 396 (C.A. 2d); *Fox River Paper Corp.* v. *United States*, 165 F. 2d 639, 640 (C.A. 7th). Further, all other relevant evidence should be considered, as was done by the Tax Court in this case (R. 941). *Olson* v. *United States*, 292 U.S. 246; *F. A. Gillespie & Sons Co.* v. *Commissioner*, 154 F. 2d 913 (C.A. 10th), certiorari

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[1] On his sales of real estate, taxpayer received from his purchasers notes for the unpaid portion of the sales price, secured by mortgages (security deeds) on the property sold. (R. 911-912.) The taxpayer's deficiencies in income tax were determined by the net-worth plus expenditures method of determining income. (Pet. 31-33.) The value of the secured notes has a bearing on the discrepancies between reported and actual income of the taxpayer, since he was required to account for cash and for property at its fair market value, received on the sale of his real estate. Section 111(b) of the Internal Revenue Code of 1939, *supra*, p. 3.

denied, 329 U.S. 781. Here, the taxpayer's own witnesses testified that the security underlying the notes was worth more than 56 percent of their face amounts, and the Tax Court in effect so found. (R. 940.) In addition, the following factors, among others in the record, support the Tax Court's valuation of the secured obligations: The obligations were being currently paid and were producing income (Joint Exs. 5-L, 6-M, 7-N; Ex. 27; Pet. 36-37, R. 911-912, 941, 956); during the taxable years they were being fully satisfied and of the numerous obligations the taxpayer owned it was necessary for him to make only one repossession (see Joint Exs. 5-L, 6-M, 7-N; Pet. 36); the taxpayer exacted promises to pay the face amounts of the obligations during the very years in question (Pet. 39); and the value of the security was worth, in some instances, much more than the face amount of the obligation.

The Tax Court was not obliged, as taxpayer insists it was, to accept the testimony of the one witness who testified that the notes were worth only 30 cents on the dollar.[2] The Tax Court is not bound to accept opinion testimony of expert witnesses, but may and should exercise its own independent judgment on the basis of all the evidence before it. *Sartor* v. *Arkansas Gas Corp.*, 321 U.S. 620, 627-628; *Dayton P. & L. Co.* v. *Commissioner*, 292 U.S. 290, 299; *Burford-Toothaker Tractor Co.* v. *Commissioner*, 192 F. 2d 633, 635 (C.A. 5th), certiorari denied, 343 U.S. 941. Here, as the court below noted (Pet. 37-39), there was evidence contradicting the conclusion of the taxpayer's witnesses and supporting

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[2] This witness had no actual experience in the purchase or sale of mortgage paper, and was not in Augusta or its vicinity during the years in issue. (R. 357-362; Pet. 37-38.)

the finding of the Tax Court—a feature which alone suffices to distinguish the case from *Nichols* v. *Commissioner*, 44 F. 2d 157 (C.A. 3d), upon which the taxpayer relies (Pet. 15, 19-20).

Nor is the decision below in conflict, as taxpayer asserts (Pet. 15), with *Miller* v. *United States*, 235 F. 2d 553 (C.A. 6th). In that case the Sixth Circuit held (p. 556) that it was error for the trial court to base its finding on the value of mortgage notes *solely* on the fact that some were satisfied in years subsequent to the years in question. In the present case the obligations were being satisfied and payments were made on them during the very years in issue; in addition, as previously noted, there are other factors which the Tax Court considered and which support its valuation finding.

2. The second question raised by the petition (Pet. 20-24) concerns the oft-litigated issue of whether sales profits are taxable as ordinary income or as capital gains. Section 117(a) and (j) of the Internal Revenue Code of 1939, *supra*, pp. 3-4, excludes from the definition of capital assets "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Whether particular property falls within the excepted category presents a question of fact in each case, no single evidentiary factor being decisive;[3] accordingly, this Court has repeatedly declined to review similar cases raising substantially the same issue.[4]

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[3] See, *e.g.*, *Simonsen Industries* v. *Commissioner*, 243 F. 2d 407 (C.A. 7th); *Gamble* v. *Commissioner*, 242 F. 2d 586 (C.A. 5th).

[4] See, *e.g.*, *Zack* v. *Commissioner*, 245 F. 2d 235 (C.A. 6th), certiorari denied, 355 U.S. 823; *S.E.C. Corp.* v. *United States*, 241 F. 2d 416 (C.A. 2d), certiorari denied, 354 U.S. 909; *Harry Slatkin Builders* v. *Commissioner*, 235 F. 2d 189 (C.A. 6th), certiorari de-

The taxpayer contended in the courts below and contends here (Pet. 21) that the real estate that was rented prior to sale was not held for sale to his customers and that, therefore, he is entitled to the capital gains tax rates on the gains from those sales. But the record here warrants the Tax Court's finding that the real estate in issue was held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business of buying and selling real estate. (R. 908-909.) Briefly stated, the record shows that the taxpayer was, during and prior to the years in question, in the business of buying and selling real estate. (R. 905-908, 946-947.) During the taxable years the taxpayer sold both property concededly held for sale and property that was rented prior to sale. (R. 454, 947.) The sales of both types of property were continuous, regular and substantial. Thus, during the years 1946 through 1948 the taxpayer sold at least 50 parcels of real estate; of these, 20 parcels were concededly held for sale and 30 parcels were those rented previous to sale. (R. 908, 947.) Moreover, although the taxpayer testified that he originally acquired the properties in question for rental purposes (R. 447), he also testified that during the taxable years he held those properties for sale (R. 448).

Since determination of this question depends upon the particular record made before the trial court, the taxpayer's contention (Pet. 20, 22-24) that the decision below is contrary to the decisions in *Curtis Co.* v. *Commissioner*, 232 F. 2d 167 (C.A. 3d), and *Victory*

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nied, 352 U.S. 928; *King* v. *Commissioner*, 189 F. 2d 122 (C.A. 5th), certiorari denied, 342 U.S. 829; *Shearer* v. *Smyth*, 221 F. 2d 478 (C.A. 9th), certiorari denied, 350 U.S. 840; *Rubino* v. *Commissioner*, 186 F. 2d 304 (C.A. 9th), certiorari denied, 342 U.S. 814.

Housing No. 2 v. *Commissioner*, 205 F. 2d 371 (C.A. 10th), is plainly without merit.[5]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
HARRY BAUM,
MELVIN L. LEBOW,
Attorneys.

APRIL 1958.

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[5] As the Tax Court noted (R. 948-949) there was, in this case, no evidence that the taxpayer had segregated properties for the definite purpose of holding them for investment and that he had embarked merely on a program of liquidation. In both *Curtis Co.* v. *Commissioner*, *supra*, and *Victory Housing No. 2* v. *Commissioner*, *supra*, the courts held that there was abundant evidence to show that the axpayers were selling property merely to liquidate an investment.

The taxpayer's incidental contention (Pet. 22), that the Tax Court ignored his testimony (citing *A. & A. Tool & Supply Co.* v. *Commissioner*, 182 F. 2d 300 (C.A. 10th)), is likewise without merit. The Tax Court specifically relied (R. 948) on the taxpayer's testimony that he held the properties in issue for sale. Additionally, there was abundant other evidence in the record, such as the continuity, number, frequency and substantiality of sales, which the Tax Court relied on for its findings. (R. 946, 948.)

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